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# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,
*Petitioner,*

VS.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
*Respondents*

**On Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit**

## BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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EDITOR'S NOTE:

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## QUESTIONS PRESENTED

The Securities Investor Protection Corporation ("SIPC"), Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag Incorporated, and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation (the "Trustees") sued Robert G. Holmes, Jr. ("Holmes") and others under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961-68 (1984) ("RICO"), for participating in a scheme to manipulate securities that caused the multi-million dollar failure of two securities firms. The district court granted summary judgment in favor of Holmes and the circuit court reversed. As restated, the Petition for a Writ of Certiorari raises two issues:

1. Did the circuit court err when it held that SIPC and the Trustees do not have to be a "purchaser or seller" of securities to bring an action as a "person injured in his business or property by reason of a violation of section 1962" consisting of "any offense . . . involving fraud in the sale of securities . . . punishable under any law of the United States"? 18 U.S.C. §§ 1964(c), 1961.

2. Did the circuit court err when it held that SIPC and the Trustees presented a triable issue that their "business or property" was "injured . . . by reason of" the conduct of Holmes in league with his co-conspirators in violation of 18 U.S.C. § 1962(d)? 18 U.S.C. § 1964(c).

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**On Petition for a Writ of Certiorari
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For the Ninth Circuit**

## BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

### STATUTORY PROVISION INVOLVED

Title 18, United States Code, in relevant part, provides as follows:

§ 1961. Definitions.

As used in this chapter —

> (1) "racketeering activity" means . . . any act . . . indictable under . . . title 18, United States Code: . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), . . . or . . . any offense involv-

ing . . . fraud in the sale of securities, . . . punishable under any law of the United States;

• • •

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

• • •

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity . . .;

§ 1962. Prohibited activities.

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise . . . .

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise . . . .

(c) It shall be unlawful for any person employed by or associated with an enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . .

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b) or (c) of this section.



§ 1964. Civil remedies.

• • •

(c) Any person injured in his business or property by reason of a violation of section 1962 . . . may sue therefor . . . and shall recover threefold the damages he sustains . . . .

Public Law 91-452 Section 904, 84 *Stat.* 947, provides as follows:

Section 904. (a) The provisions of this title shall be liberally construed to effectuate its remedial purposes.

## STATEMENT OF THE CASE

Respondents adopt as their statement of the case the introduction and facts set out by the Ninth Circuit in its opinion at 908 F.2d 1463-65:

The district court granted summary judgment in favor of defendant Holmes in this suit brought by the Securities Investor Protection Corporation ("the SIPC") and trustees of defunct stock brokerage firms. The SIPC and the trustees sued to recover losses allegedly sustained as a result of a conspiracy to manipulate the prices of stocks of publicly traded corporations. The district court concluded that the SIPC did not have standing to assert a claim under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO"), when that claim was based on alleged securities violations under section 10(b) of the Securities Exchange Act of 1934

and Rule 10b-5 promulgated thereunder.[1] The district court also determined that the defendant Holmes' acts viewed separately from those of the other alleged coconspirators were not the proximate cause of the losses sustained. We have jurisdiction under Fed. R. Civ. P. 54(b) and 28 U.S.C. § 1291 and we reverse.

## Facts

In 1970, Congress established the SIPC pursuant to the Securities Investor Protection Act, codified as amended at 15 U.S.C. §§ 78aaa-78*lll*. The SIPC was created in the wake of the collapse of numerous brokerage houses. It was created to provide greater protection to customers of brokers and dealers and members of national securities exchanges.

The SIPC is a nonprofit corporation. Its membership consists of most registered brokers and dealers. 15 U.S.C. § 78ccc(a). It has the power "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any State, Federal, or other court." 15 U.S.C. § 78ccc(b)(1). The SIPC also has the power to apply for a protective decree from a court of competent jurisdiction and to seek the appointment of a trustee for the liquidation of a broker-dealer member's business when a broker-dealer member fails or is in danger of failing to meet obligations to customers. 15 U.S.C. § 78eee.

In late July 1981, the SIPC instituted liquidation proceedings against two securities brokerages, First State Securities Corp. ("FSSC") and Joseph Sebag,

[1]Section 10(b), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5.



Inc. ("Sebag"). John L. Britton was appointed trustee for the liquidation of FSSC,[2] and Eugene W. Bell was appointed trustee for the liquidation of Sebag (collectively, "the trustees"). In the process of liquidating the brokerages, the SIPC alleges it had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

In July 1983, the SIPC and the trustees filed an action in federal district court against seventy-five defendants, alleging securities fraud in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; a conspiracy under RICO; common law fraud; and breach of fiduciary duty. The SIPC and the trustees alleged in their complaint that from 1964 through July 1981 the defendants engaged in a scheme to manipulate the stock of six companies traded in the over-the-counter market,[3] and that the defendants used FSSC and Sebag as vehicles in furtherance of this scheme. The defendants are officers and directors of the six companies and former principals and employees of FSSC and Sebag.

The SIPC and the trustees allege that the defendants misrepresented the six companies' prospects through statements by company officials, press releases, and financial statements. An illusion of active markets in the six stocks was allegedly maintained

[2]Laurence A. Schroeder is currently the successor trustee for the liquidation of FSSC.

[3]The companies are Aero Systems, Inc., Aerosonics Corp., Bunnington Corp., Creditbank, Inc., Dash Industries, Inc., and Osrow Products Corp.

by misleading transactions in the defendants' accounts, in the brokerages' proprietary accounts, and in the accounts of unsuspecting customers. When the alleged scheme was uncovered, the prices of the stocks fell drastically. Because FSSC and Sebag held large amounts of the stocks in their proprietary accounts, they incurred heavy losses, leading to the liquidation proceedings.

The present appeal is the third to reach this court in this litigation. In *Securities Investor Protection Corp. v. Vigman,* 764 F.2d 1309 (9th Cir. 1985), the district court dismissed four defendants for lack of personal jurisdiction and improper venue. As to lack of personal jurisdiction, we reversed the dismissal of one defendant and remanded the dismissal of another for further consideration. *Id.* at 1316. We also remanded for further proceedings the district court's dismissal of these two defendants on the ground of improper venue. *Id.* at 1318. In *Securities Investor Protection Corp. v. Vigman,* 803 F.2d 1513, 1519-1520 (9th Cir. 1986), we reversed the dismissal of the SIPC's 10-b5 claims.

Robert G. Holmes, Jr., the only defendant involved in this appeal, is the founder, the chief executive officer, the president, and a major shareholder of Aero Systems, Inc. ("Aero"), one of the six companies whose stock was allegedly manipulated. Holmes also was a shareholder in Bunnington Corp. ("Bunnington"), another one of the six companies, during the period of the alleged manipulation. The SIPC and the trustees allege that Holmes participated in a conspiracy with certain other defendants to manipulate the price of Aero and Bunnington stock. They allege that Holmes issued false and misleading press



releases and other public statements regarding a new product Aero was marketing to inflate artificially the price of Aero's stock. Further, they assert that Holmes helped other defendants manipulate the price of Bunnington's stock by purchasing large blocks of Bunnington stock and then selling in small lots, thus creating the appearance of an active trading market. Finally, the plaintiffs allege that Holmes helped conceal FSSC's poor financial position by allowing FSSC to "park"[4] shares of Bunnington stock in Holmes' trading account.

Holmes moved for summary judgment, asserting that the SIPC lacked standing to assert a RICO claim because the SIPC was not a purchaser or seller of securities. Holmes also contended that any conduct he engaged in did not cause the losses which the SIPC and the trustees sustained.

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[4] "Parking" is a mechanism used to evade the net capital requirements of the National Association of Securities Dealers ("NASD"). When a brokerage firm files the required monthly report with the NASD regarding its net capital condition, it must discount in value any stock it holds in its own account (referred to as a "haircut"). To reach technical compliance with its net capital requirements, a brokerage firm "sells" stock from the brokerage's own account to a customer at market price. This avoids the discounting for reporting purposes. Once the brokerage firm has filed its report with the NASD and met its net capital requirement, the firm "buys" the shares back from the customer, usually at the same price at which it sold the stock plus interest.

The SIPC and the trustees allege that Holmes conspired with FSSC to park shares of Bunnington in Holmes' account to allow FSSC to mask its net capital deficiencies in its reports to the NASD. This allegedly allowed FSSC to continue its participation in the overall manipulation conspiracy.

The district court granted Holmes' motion for summary judgment. The district court concluded that genuine issues of material fact existed as to the elements of the RICO claim, including whether Holmes conspired to violate RICO, but it concluded that the SIPC did not meet the purchaser-seller requirement for standing to assert a RICO claim predicated upon violations of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

The district court also concluded that a genuine issue of material fact existed as to whether Holmes' acts, upon which the RICO claim was based, were the *actual cause* of the losses to the SIPC and the trustees, but that there was no genuine issue for trial to dispute the fact that Holmes' acts were not the *proximate cause* of the losses. The district court reached its proximate cause conclusion by isolating Holmes' acts from the acts of other members of the alleged conspiracy, and by applying a "loss causation" requirement to the RICO claim.

The circuit court reversed the grant of summary judgment, holding both that SIPC need not be a purchaser or seller of securities under RICO and that as a conspirator, Holmes is responsible for the acts of others undertaken in furtherance of the illegal agreement. Petitioner now seeks this Court's review.

## SUMMARY OF REASONS FOR DENYING THE WRIT

It is not necessary for this Court to review the Ninth Circuit's decision that SIPC need not be a purchaser or seller of securities to maintain claims under RICO. The split in the circuit courts is not sufficiently defined to indicate that review is appropriate; nor have the circuit



courts fully developed the arguments for or against application of the purchaser/seller standing limitation to RICO. Moreover, the Ninth Circuit's ruling was correct as a matter of statutory construction.

Petitioner's second issue regarding causation also is not appropriate for review. The district court clearly found issues of material fact to support Respondents' allegation of a conspiracy to violate RICO and the Ninth Circuit affirmed the long standing rule that conspirators are liable for the acts of others undertaken in furtherance of the agreement. For the foregoing reasons, the Petition for a Writ Certiorari should be denied.[1]

## REASONS FOR DENYING THE WRIT

### A. The Purchaser/Seller Standing Issue Does Not Require Review By This Court.

#### 1. Review Of The Application Of Purchaser/Seller Limitations To RICO Is Not Yet Ripe.

Petitioner contends that the Ninth Circuit's decision not to read "purchaser-seller" standing limitations into the text of RICO is in conflict with the positions of the Fourth and Eighth Circuits (Petition at 7-8.) While this may be so,[2] the conflict is not ripe for review. *See McCray*

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[1]The Ninth Circuit asserted jurisdiction over Holmes' appeal pursuant to Federal Rule of Civil Procedure 54(b), permitting entry of judgment in favor of one of multiple parties, and 28 U.S.C. Section 1291. The case remains pending in the district court as against the remaining defendants, but has been stayed during proceedings in this Court.

[2]*Compare Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461, 1465-67 (9th Cir. 1990), *and Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir. 1987), *with Brannan v. Eisenstein*, 804

*v. New York*, 461 U.S. 961, 962-63 (1983) (Stevens, J.) (certiorari denied where issue requires further study); *Maryland v. Baltimore Radio Show, Inc.*, 338 U.S. 912, 918 (1950) (Frankfurter, J.) ("[D]esirable to have different aspect of an issue further illumined by the lower courts[,] ... [as] wise adjudication has its own time for ripening"). Only the decisions of the Fourth and Ninth Circuits represent full-scale treatments of the text, precedent, and policy considerations raised by this Petition. The decisions of the Eleventh and Eighth Circuits are at best cryptic. As such, this Court's review ought to be postponed until, if ever, the basic arguments have been fully made, the positions deliberately taken and fully developed, and the conflict among several circuits has become irreconcilable.

A debate that includes only opening remarks by each side, but no rebuttal, is not ripe for resolution. It would be helpful, for example, to hear from the Second and Seventh Circuits, each of which has extensive expertise in RICO and securities litigation. Indeed, the well-reasoned position of the Ninth Circuit may come to represent the majority view, and the Fourth Circuit may be led to reverse its narrow reading of the statute, making review by this Court unnecessary. *See, e.g., Busby v. Crown Supply, Inc.*, 896 F.2d 833, 840-42 (4th Cir. 1990) (person-enterprise rule under Section 1962(a) abandoned in light of contrary precedent in other circuits).

Petitioner suggests grave consequences from an onslaught of civil RICO litigation. Petitioner's contention is incorrect.

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F.2d 1041, 1046-47 (8th Cir. 1986) *and International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987).



First, Congress wanted RICO to apply to both "legitimate" and "illegitimate" enterprises. *H.J. Inc. v. Northwestern Bell Telephone Co.*, 109 S.Ct. 2893, 2902-05 (1989); *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 499 (1985); *United States v. Turkette*, 452 U.S. 576, 580-81 (1981). Second, it is not true that the federal courts are being overwhelmed by civil RICO litigation now[3] or that they would be under the Ninth Circuit's rule. In fact, only approximately 1,000 RICO cases are filed out of a total of 240,000 filings each year. *Myths* at 870. Common law fraud is alleged in approximately 52.7% of these cases, while securities fraud is alleged in approximately 32%.[4] As such, the number of securities-type cases that might be filed as RICO actions could increase at the maximum from approximately 320 to 527 filings. Since approximately 58.6% of RICO suits have an independent basis for federal jurisdiction (*id.*), the increase in new federal litigation probably would not exceed 218 new cases.

These data, moreover, do not fully factor in this Court's efforts to further refine application of the RICO Act. *See H.J. Inc.*, 109 S.Ct. at 2899 (two predicate acts, without more, is insufficient). Even before *H.J. Inc.*, the circuits were properly declining to turn RICO into a general tort statute based on multiple mailings. *See, e.g., Elliott v. Chicago Motor Club Ins.*, 809 F.2d 347, 350 (7th Cir. 1987) ("multiplicity of mailing does not necessarily translate directly into a 'pattern' ") (*quoting Lipin Enterprises Inc. v. Lee*, 803 F.2d 322, 325 (7th Cir. 1986) (Cudahy, J., concurring)). That course of action continues after *H.J.*

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[3]Blakey & Perry, *An Analysis of the Myths that Bolster Efforts to Rewrite RICO*, 43 Vanderbilt. L. Rev. 851, 869-73 (1990) (analysis of docket filings) ("*Myths*").

[4]Blakey & Cessar, *Equitable Relief Under Civil RICO*, 62 Notre Dame L. Rev. 526, 621 (1987) ("*Equitable Relief*").

*Inc.* Finally, Congress, albeit slowly, is inexorably moving to narrow the scope of civil RICO. *See* S. Rep. No. 101-269, 101st Cong., 2nd Sess. (1990) (reporting S. 438); 6 Civil RICO Rep. 1 (Sept. 25, 1990) (noting reporting of H.R. 5111).

The invitation of Petitioner to this Court to undertake a similar effort is inappropriate. *H.J. Inc.*, 109 S.Ct. at 2905 ("a job for Congress"); *Sedima*, 473 U.S. at 500 ("a form of statutory amendment [in]appropriately undertaken by the courts"); Note, *Civil RICO: The Temptation and Impropriety of Judicial Restriction*, 95 Harv. L. Rev. 1101 (1982). More than a little irony is also present in Petitioner's reliance on *Blue Chip Stamps v. Manor Drug-stores*, 421 U.S. 723, *reh'g denied*, 423 U.S. 884 (1975). *See Id.* at 748: "[T]he Judiciary *may not circumscribe a right which Congress has conferred* because of any disagreement it might have with Congress about the wisdom of creating sc expansive a liability." (emphasis added).

### 2. The Ninth Circuit's Holding Regarding The Purchaser/Seller Issue Was Correct, Further Indicating That Review Is Not Required.

Although not binding here, Respondents submit that the Ninth Circuit was correct in its interpretation of RICO, and that the Fourth Circuit was in error.[5] Interpretation of RICO begins with its text; structure as well as language is important. *Russello v. United States*, 464 U.S. 16, 22-23 (1983); *Turkette*, 452 U.S. at 587. Title 18 Section 1962 is enforced by private suits through 18

[5]The Trustees, in their capacities as purchasers of the manipulated securities, meet the purchaser/seller rule under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The Trustees' standing to present their claims has not been disputed in this case. The purchaser/seller issue is raised only as to SIPC.



U.S.C. Section 1964(c), which provides that "[a]ny person injured in his business or property by reason of a violation of 1962" may sue. The definition of "person" includes "any entity." 18 U.S.C. § 1961(3). The plain text of RICO, therefore, does not impose "purchaser or seller" limitations. "[T]he plaintiff only has standing if . . . he has been injured in his business or property by the conduct constituting the violation . . . But the statute requires no more than this." *Sedima,* 473 U.S. at 496-97. The private right under RICO is express; judicial standing limitations, therefore, are improper. *Blue Chip Stamps*, 421 U.S. at 748-49.[6]

The language of RICO is plain, and this Court's teachings preclude judicially imposed limitations. Nevertheless, the Fourth Circuit in *Zepkin* held otherwise. Conceding that Congress did not *expressly* limit RICO by "purchaser or seller" limitations and noting the absence, not only of "purchaser-seller" language, but also of Section 10(b)'s "in connection with" causation standard, the *Zepkin* court held that explicit statutory language was required in RICO to overcome judicially imposed limitations on private actions under Rule 10b-5. *Zepkin*, 812 F.2d at 152. *Zepkin* is fundamentally misguided, misreads the statutory scheme of RICO, and reflects bad policy. *See Fedorenko v. United States*, 449 U.S. 490, 513 (1981) (The Court is "not at liberty to imply a condition which is opposed to the explicit terms of the statute. . . . To [so] hold . . . is not to construe the Act but to amend it.")

[6]Respondents' First Amended Complaint also included mail and wire fraud among the alleged predicate offenses under 18 U.S.C. Sections 1961(1) and 1962. The district court, without analysis, extended its "purchaser/seller" holding on offenses involving fraud in the sale of securities to these other predicate acts.

(*quoting Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21, 38 (1934)).

First, *H.J. Inc.* and *Sedima* squarely hold that RICO's express text, structure, and legislative history, not silence in its text or legislative history, control the interpretation of RICO. *H.J. Inc.*, 109 S.Ct at 2899; *Sedima*, 473 U.S. at 495 n.13. RICO must be liberally construed, and its remedial purposes are to be enhanced, not retarded. *Sedima*, 473 U.S. at 497-98. The Fourth Circuit rejects the liberal construction clause for its narrow interpretation of the statute. Indeed, *Zepkin* does not even address 18 U.S.C. Section 1964, the civil provision that, in fact, *expressly* deals with standing, injury, and causation. As this Court noted in *Sedima*, it was expressly to avoid judicially created standing limitations on RICO's remedies that the legislation was enacted outside of the antitrust statutes. *Id.* at 498. By reading such limitations into RICO, the Fourth Circuit "create[s] exactly the problems Congress sought to avoid." *Id.* at 499.

Rule 10b-5 standing limitations are inapplicable to RICO on another ground. The purchaser/seller limitation of Rule 10b-5 is imposed only for private civil actions. The violation of Rule 10b-5 that constitutes a predicate act under RICO, however, is a *criminal* securities fraud. "[O]ffense . . . punishable . . ." "obviously refers to [the] criminal" provisions of the securities statutes. *Trane Co. v. O'Connor Securities*, 718 F.2d 26, 29 (2d Cir. 1983). *See* Section 32(a) of the Securities Exchange Act of 1934, 48 Stat. 904 ("willfully violates").[7]

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[7]The standard of Section 32(a) is not limited by "purchaser-seller" limitations. *United States v. Charnay*, 537 F.2d 341, 349 n.11 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976) ("In a criminal prosecution, the standing problem is . . . not present and Rule 10b-5 is applicable. . . .") *See also United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979) (*Blue Chip Stamps* does not limit criminal provision); *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983) ("It is only because the judiciary . . . created a private cause of action . . . that standing . . . has become a pivotal issue.")



Plaintiffs under RICO, especially public benefit corporations such as SIPC, act as private prosecutors.[8] Had Congress wanted to impose "purchaser-seller" standing limitations on this civil enforcement mechanism, it could have done so with appropriate language. Congress was well aware of the overlap between RICO and the securities statues, as the point was specifically drawn to its attention.[9] As such, forcing civil RICO into a purely private law model, as the Fourth Circuit does in *Zepkin*, misconceives civil RICO's important *public* law functions.[10]

No language in the mail or wire fraud statutes, moreover, warrants reading into them, as the district court did, the "purchaser or seller" limitations. Nor does *Zepkin* address standing under the mail or wire fraud statutes, as it only involved a Rule 10b-5 claim. 812 F.2d at 151 (standing under other claims not decided). The

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[8]Respondents also add that in another context, this Court considered the provisions of SIPA. *SIPC v. Barbour*, 421 U.S. 412, 415-18 (1975). *See also In re Executive Secs. Corp.*, 702 F.2d 406, 410 (2d Cir. 1983), where the Second Circuit stated that both SIPC and the trustees appointed under SIPA vindicate important public purposes.

[9]Blakey, *RICO Civil Action in Context*, 68 Notre Dame L. Rev. 237, 272-73 (1982).

[10]*See generally* Chayes, *Forward: Public Law Litigation and the Burger Court*, 96 Harv. L. Rev. 4, 5 (1982) (classic model of private dispute resolution contrasted with contemporary model of public grievances against aggregates of power); *Id.* at 8-26 (inappropriate private law standing limitations analyzed); Chayes, *The Role of the Judge in Public Law Litigation*, 89 Harv. L. Rev. 1281 (1976).

purpose of the two statutes, taken together, is to prohibit schemes to defraud that utilize, in varying circumstances, the mails or interstate wire communications. *Parr v. United States,* 363 U.S. 370, 389 (1960). The statutes say nothing about "purchasers or sellers."

Only two elements need come together to establish a mail or wire fraud violation: a scheme to defraud and the use of the mails or interstate wires to execute it. *Pereira v. United States,* 347 U.S. 1, 8-9 (1954). A "scheme to defraud" is not limited to common law concepts of fraud. *Durland v. United States,* 161 U.S. 306, 314 (1896). *See generally United States v. Bohonus,* 628 F.2d 1167, 1171 (9th Cir.), *cert. denied,* 447 U.S. 928 (1980) ("non-technical standard") (*citing United States v. Louderman,* 576 F.2d 1383, 1389 (9th Cir.), *cert. denied,* 439 U.S. 896 (1978)).

Conceptual difficulties may arise, however, when parties or courts "confus[e] mail fraud with common law fraud" (*Armco Indus. Credit Corp. v. SLT Warehouse Co.,* 782 F.2d 475, 481 (5th Cir. 1986)), since (1) neither "purchaser or seller" standing limitations, (2) materiality or justifiable and detrimental reliance, nor (3) misrepresentation or omission are elements that circumscribe the substantive definition of a "scheme to defraud" in the mail and wire fraud statutes incorporated into RICO.[11] Accordingly, neither mail nor wire fraud's concepts of "scheme to defraud" under RICO are limited by "purchaser or seller" standing or similar common law requirements. As such, the district court's summary judgment cannot be legally justified. It is not necessary to decide the case to reach the alleged conflict between the Fourth and Ninth Circuits claimed to exist under securities fraud as a predicate offense. The Petition for a Writ of Certiorari, therefore, should be denied. *See The Monrosa v. Carbon Black Export, Inc.,* 359 U.S. 180, 183-84, *reh'g denied,* 359 U.S. 999 (1959).

[11] *Brandenburg v. Seidel,* 859 F.2d 1179, 1187 (4th Cir. 1988) (no detrimental reliance required for mail or wire fraud); *Armco Indus. Credit Corp.,* 782 F.2d at 481-82 (no justifiable or detrimental reliance required for mail fraud); *McLendon v. Continental Group, Inc.,* 602 F. Supp. 1492, 1506-10 (D.N.J. 1985) (RICO scheme to defraud: noting inapplicability of misrepresentation or omission in "scheme to defraud").



### B. Review Of The Scope Of Conspiratorial Liability Under RICO Is Not Warranted.

Petitioner contends that the circuit court's decision holding that a conspirator is liable for his co-conspirator's conduct ought to be reviewed by this Court. In doing so, Petitioner argues that his acts as a conspirator must have caused the plaintiffs' harm and that there are no district court findings that any act in furtherance of the conspiracy to manipulate the six companies' securities caused the collapse of the brokerage firms. (Petitioner's Brief, pp. 16-22.) Petitioner not only misstates the law; he also misrepresents the record below and conveniently *fails to acknowledge his own admissions* before the District Court.

#### 1. There Is No Split In The Circuits On The Issue Of Whether Conspirators Are Liable For The Acts Of Their Co-Conspirators.

Petitioner identifies no decision of this Court or of a circuit court holding that conspirators are not liable for the injury-causing acts of their co-conspirators. As such, review by this Court is not required. In fact, the general rule at common law and under various federal statutes fully supports the Ninth Circuit's decision.

Under the common law, once a conspiracy is shown, any injury inflicted by an overt act in furtherance of the

conspiracy is civilly actionable. *Nalle v. Oyster,* 230 U.S. 165, 182 (1913) ("[T]he well-settled rule is that . . . [a] civil action lies for conspiracy [if] . . . an overt act . . . results in damage to the plaintiff."); *Kashi v. Gratsos,* 790 F.2d 1050, 1054 (2d Cir. 1986) (common law fraud) (liable for all damages caused, not just personal involvement); *Hooks v. Hooks,* 771 F.2d 935, 944 (6th Cir. 1985); *Halberstam v. Welch,* 705 F.2d 472, 487 (D.C. Cir. 1983) (common law fraud); Restatement (Second) of Torts, § 876(a) (1977) ("pursuant to a common design"); *id.* comments a, b ("conspiracy"). Conspiracy is not the basis of the claim; it is the injury that flows from an overt act that forms the basis for compensation. The rule is universally followed without difficulty in the lower courts. *See, e.g., United States v. Excellair, Inc.,* 637 F. Supp. 1377, 1388 n.7 (D. Colo. 1986); *Weise v. Reisner,* 318 F. Supp. 580, 583 (E.D. Wis. 1970); Restatement (Second) of Torts, § 876, comment b ("agreement is not enough . . . acts of a tortious character in carrying it into execution"). Litigation under federal statutes follows a similar and uniform path. *See, e.g., Griffin v. Breckenridge,* 403 U.S. 88, 103 (1971) (Civil Rights Act, 42 U.S.C. § 1985 (3)).[12] Accordingly, nothing here merits this Court's review.

### 2. Petitioner's Attempt To Distance Himself From His Co-Conspirators Does Not Warrant The Court's Review.

Petitioner also argues that "there was no finding of a genuine dispute concerning whether Holmes was a con-

[12] *Lenard v. Argento,* 699 F.2d 874, 883 (7th Cir.) (Civil Rights Act, 42 U.S.C. § 1985(3)) *cert. denied,* 464 U.S. 815 (1983); *Lawrence v. Acree,* 655 F.2d 1319, 1324 (D.C. Cir. 1981) (same); *Ostrofe v. H.S. Crocker Co.,* 740 F.2d 739, 744 (9th Cir. 1984) (antitrust), *cert. dismissed,* 469 U.S. 1200 (1985); *Beltz Travel Service, Inc. v. Int'l Air Transport Ass'n,* 620 F.2d 1360, 1366-67 (9th Cir. 1980) (antitrust) ("[R]egardless of the nature of [defendants'] own actions."); *Donahue v. Pendleton Woolen Mills, Inc.,* 633 F. Supp. 1423, 1437 (S.D.N.Y. 1986) (antitrust); *Int'l Longshoremen's Union v. Juneau Spruce Corp.,* 189 F.2d 177, 189-90 (9th Cir. 1951) (Taft-Hartley Act, 29 U.S.C. § 187(b)), *aff'd on other grounds,* 342 U.S. 237 (1952); *Simeon v. T. Smith & Son, Inc.,* 852 F.2d 1421, 1430-32 (5th Cir.) (Jones Act) (46 U.S.C. § 688) (not limited to percentage of fault), *reh'g en banc denied,* 860 F.2d 1255 (1988), *cert. denied,* 109 S.Ct. 3156 (1989) *Lyon v. Ranger III,* 858 F.2d 22, 28 (1st Cir. 1988) (concert of action under maritime law) ("not only for his own acts but also for the acts of others with whom he acts in concert."); *Ferguson v. Omnimedia, Inc.,* 469 F.2d 194, 197 (1st Cir. 1972) (securities fraud) (liable even though not engaged in act causing harm); *Herpich v. Wilder,* 430 F.2d 818, 819 (5th Cir. 1970) ("[H]aving allegedly joined the conspiracy and taken steps to assure its success, [defendant] may be held responsible for the acts of his co-conspirators in furtherance of their scheme."), *cert. denied,* 401 U.S. 947 (1971).



spirator in any conspiracy that caused the brokerage firms' losses . . . . Conspicuous by its absence is any finding by the District Court or ruling by the Ninth Circuit that there is a genuine issue of fact whether Holmes was a co-conspirator in the conspiracy that caused the brokerage firms' loss." (Petitioner's Brief, pp. 17-18.) It is unclear whether Petitioner now contends he was not a conspirator or whether he argues that no acts in furtherance of the agreement caused the loss.

Petitioner cannot maintain there was no finding that he conspired to violate RICO. In fact, the district court, in its revision of Petitioner's proposed Order Granting Summary Judgment (RICO Claims), *specifically found* that "there is [a] genuine dispute regarding material facts with respect to the following issues, i.e., whether . . . Robert G. Holmes, Jr. conspired to violate RICO Sections

1962(a); 1962(b); or 1962(c)."[13] (C.R. 1317, Petitioner's Appendix, p. 45a.) The district court then *did* find genuine issues of material fact supporting the Respondents' allegation that there was a conspiracy to violate RICO and that Petitioner was a member of that conspiracy. (C.R. 1343, Petitioner's Appendix, p. 45a.) The circuit court, which reviewed the record *de novo,* noted that the district court's finding of genuine issues of material fact to support a conspiracy was inconsistent with the finding that Petitioner was not legally responsible for the acts of his co-conspirators. 908 F.2d at 1468-69. The circuit court therefore reversed, correctly noting that all conspirators are liable for the acts of their co-conspirators undertaken in furtherance of the illegal agreement. 908 F.2d at 1469.

Petitioner also apparently argues that there is no finding of a genuine issue of fact whether the conspiracy involving Holmes caused Respondents' loss. Petitioner's argument is surprising in that Peitioner argued before the district court, that the acts of others[14] brought about the manipulation of Bunnington and Aerosonics stock and that those acts were the cause of the losses to SIPC and the Trustees. (C.R. 1281, Appendix p. A-7.)

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[13]Holmes' proposed order, submitted to the district court, originally read "there is no evidence that Robert G. Holmes, Jr. conspired to violate RICO Sections 1962(a); 1962(b); or 1962(c)." The district court disagreed with Petitioner's proposed order and struck the phrase "there is no evidence that", leaving its finding that SIPC met its burden under Federal Rule of Civil Procedure 56 in demonstrating that Holmes conspired with others to violate RICO. (C.R. 1343, Petitioner's Appendix, p. 45a.)

[14]The acts of Holmes' co-defendants were factually linked to Holmes and the Aerosonics and Bunnington stock manipulations by the evidence before the district court.



Petitioner himself affirmatively alleged below that the price of Bunnington Corporation stock, one of the manipulated securities, was "artificially inflated" and that the large concentration of Bunnington and Aerosonics securities in the FSSC and Sebag inventory accounts was a "substantial cause of the demise of the brokerage houses." (C.R. 1281, Appendix, p. A-7.) Respondents directly tied Holmes to the manipulation of Bunnington stock by introducing evidence showing that Holmes participated with, and provided substantial assistance to, his co-conspirators.[15]

Petitioner, however, never argued before the district or circuit courts that the conspiracy did not cause the loss. Petitioner, in fact, argued precisely the opposite; *i.e.*, that the manipulation of securities by others in furtherance of the illegal conspiracy caused the brokerage firms' demise.

Petitioner's efforts before this Court to distance himself from his co-conspirators are unavailing. As a conspirator, Holmes is responsible in damages for those acts, whether he committed them in person or not. "'[A] conspiracy [is] not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole.'" *Beltz Travel Serv., Inc. v. Int'l Air Transp. Ass'n,*

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[15]Holmes' own acts in furtherance of the conspiracy to conduct the enterprise's affairs and thereby manipulate the six securities included, *inter alia*: (1) manipulating the price of Aero Systems stock by issuing materially false and misleading press releases; (2) assisting the brokerage firms to obtain a higher price for Aero Systems stock, thereby bankrolling the Bunnington and Aerosonics manipulations with proceeds from the sale of Aero Systems stock; (3) purchasing Bunnington stock in large blocks while selling only in small lots to create the appearance of a widespread market for Bunnington stock when, in fact, no such market existed; and (4) "parking" Bunnington stock to mask FSSC's net capital deficiency. (C.R. 1310, Appendix, pp. B-1 to B-37.)

620 F.2d 1360, 1366 (9th Cir. 1980), quoting *United States v. Patten*, 226 U.S. 525, 544 (1913). The circuit court, taking the district court's finding of a genuine issue of material fact supporting Respondents' allegation that Holmes participated in the conspiracy, held that "if the district court properly concluded that there was a genuine issue as to whether Holmes conspired to violate RICO, the district court erred in granting Holmes' motion based on a conclusion that his conduct alone did not proximately cause the injuries alleged." 908 F.2d at 1469. There is no conflict in the circuits on this important legal principle; neither is this Court's guidance needed to further reinforce the longstanding rule that co-conspirators are legally responsible for the acts of their confederates or, for that matter, their own acts in furtherance of the conspiracy itself. Therefore, this Court's attention to the Petition is not required and the writ of certiorari should not be granted.



## CONCLUSION

For these reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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CASE NO. CV 83-4742-AWT(Tx)

# United States District Court

CENTRAL DISTRICT OF CALIFORNIA

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SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

*Plaintiffs,*

vs.

SEYMOUR VIGMAN, et al.,

*Defendants.*

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AND CONSOLIDATED ACTIONS.

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**NOTICE OF MOTION AND MOTION OF DEFENDANT ROBERT G. HOLMES, JR. FOR SUMMARY JUDGMENT ON ISSUE OF CAUSATION; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF**

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on October 17, 1988, at __ o'clock a.m. or as soon thereafter as counsel can be heard, in the courtroom of the Honorable A. Wallace Tashima, United States District Judge, 312 North Spring Street, Los Angeles, California, defendant Robert G. Holmes, Jr. will move for summary judgment on all

claims brought against him by Plaintiff Securities Investor Protection Corporation and Plaintiffs Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Inc. and Lawrence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation.

This Motion for Summary Judgment is made pursuant to Rule 56 of the Federal Rules of Civil Procedure, on the grounds that the uncontroverted facts and controlling authorities on the issue of loss causation entitle Holmes to judgment as a matter of law.

This Motion for Summary Judgment is based upon this Notice of Motion, the attached Memorandum of Points and Authorities in Support Thereof, the Statement of Uncontroverted Facts and Conclusions of Law filed concurrently herewith, the Exhibits to Motion of Defendant Robert G. Holmes, Jr. for Summary Judgment on Issue of Causation and Declaration of Richard P. Walker filed concurrently herewith, and such oral argument as may be presented by counsel at the time of the hearing.

Dated: December , 1990

JACK I. SAMET
RICHARD P. WALKER
BUCHALTER, NEMER, FIELDS &
YOUNGER
A Professional Corporation

By _____
Richard P. Walker
*Attorneys for Defendant*
*Robert G. Holmes, Jr.*



## MEMORANDUM OF POINTS AND AUTHORITIES

### I.

### INTRODUCTORY STATEMENT

This motion for summary judgment on the issue of causation (the "Motion") is brought by Robert G. Holmes, Jr. ("Holmes"), who is the founder, president and chief executive officer of Aero Systems, Inc. ("Aero Systems"), a Miami-based avionics firm. Both Aero Systems in its corporate capacity and Holmes in his individual capacity are named as defendants in the *SIPC, et al. v. Vigman, et al.* action (the "action"). This Motion is brought to adjudicate the claims asserted by plaintiff Securities Investor Protection Corporation ("SIPC") and plaintiffs Eugene W. Bell, Trustee for the Liquidation of Joseph Sebag, Inc. ("Sebag") and Laurence A. Schroeder, Successor Trustee for the Liquidation of First State Securities Corporation ("FSSC") ("Trustees"), and is inapplicable to the claims asserted by the plaintiff class in the action.

The proposition this Motion intends to establish can be simply stated: Robert Holmes did not cause the damages alleged by SIPC and the Trustees, because he did not cause Sebag or FSSC to fail, or cause them to fail to comply with applicable net capital requirements. If Sebag or FSSC had not failed, SIPC and the Trustees would not have incurred any of the claimed expenses for which recovery is sought in this action (payment of customer claims and administrative expenses in the liquidation proceedings of Sebag and FSSC). Since Holmes did not cause Sebag or FSSC to fail, his alleged actions could not have been the proximate or legal cause of SIPC's damages. For similar reasons, since Holmes did not cause Sebag or FSSC to fail, the Trustees are not entitled to

recover against Holmes for destruction of the business or good·vill of those firms. Since no genuine issue of fact exists that Holmes caused the losses complained of, he cannot be legally responsible for the damages. Based on the uncontroverted facts and the controlling authorities, Holmes is entitled to judgment as a matter of law.

## II.

## STATEMENT OF FACTS

On July 21, 1981, all trading by FSSC was halted for violation of net capital requirements under Securities and Exchange Commission Rules 15c-3-1 and 15c-3-3. (*See* Uncontroverted Fact No. 1 of concurrently filed Statement of Uncontroverted Facts and Conclusions of Law (hereinafter "U.F. __").) On the same date, all trading by Sebag was halted for violation of the same net capital rules (U.F. 3). On July 24, 1981, SIPC, acting pursuant to the provisions of the Securities Investor Protection Act of 1970 (15 U.S.C. § 78 *et seq.*) ("SIPA"), obtained a protective decree regarding the bankruptcy estate of FSSC, as a consequence of which a trustee named by SIPC was appointed to liquidate the business of FSSC, to pay customers of FSSC monies from the bankruptcy estate and monies advanced by SIPC, and to perform certain other duties set forth in SIPA (U.F. 2). On July 27, 1981, SIPC obtained a protective decree regarding the bankruptcy estate of Sebag, as a consequence of which a trustee named by SIPC was appointed with similar duties as the trustee for the estate of FSSC (U.F. 4) In all, SIPC, through the Trustees, claims to have been damaged in the amount of at least $4.0 million ($4,000,000) in performing its duties liquidating the estate of FSSC and paying FSSC's customers pursuant to authority granted to SIPC and the Trustees by SIPA



(U.F. 6). For the estate of Sebag, SIPC claims vastly higher damages exceeding at least $26.2 million ($26,200,000) (U.F. 5).

This action was brought by SIPC and the Trustees (hereinafter "Plaintiffs") against Joseph Lugo ("Lugo") and other principals of FSSC and Sebag, and against numerous corporations whose stocks had been traded by these brokerage houses, and principals of those corporations, purportedly to recover sums Plaintiffs claim to have expended in liquidating the estates and paying the customers of FSSC and Sebag.

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## V.

## PLAINTIFFS' CAUSATION ALLEGATIONS DO NOT RAISE A GENUINE ISSUE OF FACT

### A. Plaintiffs' Loss Causation Theory

For purposes of this Motion, it is uncontroverted that the liquidation of FSSC and Sebag resulted in the expenditure of sums which Plaintiffs are seeking to recover as damages in this action, and that FSSC and Sebag were liquidated because of their net capital deficiencies (U.F. 1-6). It is, then, necessary to determine whether a genuine issue for trial exists as to whether Holmes in some way caused the net capital deficiencies of FSSC and Sebag.

Plaintiffs' loss causation theory against Holmes is set forth in Plaintiffs' Responses to Third Set of Interrogatories Propounded by Defendant Robert G. Holmes, Jr. ("Plaintiffs' Interrogatory Responses"), a copy of which is annexed as Exhibit "3" to the concurrently filed Exhibits to Motion of Defendant Robert G. Holmes, Jr. for

Summary Judgment on Issue of Causation (hereinafter "Exhibit __ hereto"), which is incorporated herein by reference. In these interrogatory responses, Plaintiffs incorporate by reference a list of allegedly false and misleading statements issued by Holmes which allegedly artificially inflated the price of Aero Systems stock. Assuming solely for the purpose of this Motion (but without admitting) that Plaintiffs' allegations are true and that Holmes did manipulate the price of Aero Systems stock, the relevant question is, was this alleged manipulation the legal cause of the brokerage houses' net capital deficiencies? If not, did Holmes engage alone, or with others, in any other conduct which was the legal cause of the failure of the brokerage firms?

If a manipulation of Aero Systems stock had caused the brokerage firms to fail, one would expect to see large quantities of Aero Systems stock in the inventories of FSSC and Sebag at the time they ceased doing business, and one would also expect to see the price of Aero Systems stock immediately and precipitously drop when they ceased doing business, as a result of the market for Aero Systems stock being controlled and dominated by the brokerage houses and its price being maintained at an artificially inflated level. Indeed, with certain other issuers who are defendants in this action and whose stock was traded by FSSC and Sebag, this was precisely the case. In closing inventories, FSSC had 33,443 shares (U.F. 7) and Sebag had 73,640 shares (U.F. 8) of Bunnington Corporation stock. Bunnington stock immediately dropped in price from $10⅜ per share to $2½ per share within three days after the brokerage houses were closed (U.F. 9). Similarly, FSSC had 33,022 shares (U.F. 10) and Sebag had 226,910 shares (U.F. 11) of Aerosonic Corporation stock in closing inventories. Aerosonic stock also dropped in price substantially, from $11¼ per share



to $5½ per share, within three days after the brokerage houses were closed (U.F. 12).

The National Association of Securities Dealers ("NASD"), in conducting "autopsy" investigations of the cause of the failure of FSSC and Sebag, concluded that *the large concentration of artificially inflated Bunnington and Aerosonic stock in FSSC's and Sebag's closing inventories was a substantial cause of the demise of the brokerage houses* (U.F. 16; *see* NASD report regarding FSSC, Exhibit 4 hereto: "Shortly after [FSSC's] withdrawal . . . , NASDAQ quotes in Bunnington and Aerosonic fell drastically . . . the decline in market value of inventory positions . . . resulted in a negative net worth . . . A review of inventory positions . . . discloses that . . . the firm began carrying positions which were clearly excessive relative to its capital . . . . " (*Id.*, pp. 1-3); *see also*, NASD report regarding Sebag, Exhibit 5 hereto: "The demise of Joseph Sebag, Inc. appears to be a result of inadequate supervision of a registered representative. Net capital and 15c-3 problems stemmed from the buildup of firm inventory generated from unauthorized customer transactions." *Id.* at p. 4.) The report regarding Sebag stated that these unauthorized transactions were in the securities of "Aerosonics, Bunnington, and Osrow." *Id.* at p. 2.))

CASE NO. CV 83-4742-AWT (Tx)
(Consolidated Cases)

# United States District Court

CENTRAL DISTRICT OF CALIFORNIA

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SECURITIES INVESTOR PROTECTION CORPORATION, et al.,
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AND CONSOLIDATED ACTIONS.

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Case No. CV 83-4742-AWT (Tx)
(Consolidated Cases)

## STATEMENT OF BACKGROUND AND FACTS

[Filed Concurrently with Memoranda of Points and Authorities in Opposition to Holmes' Motions for Summary Judgment]

[Filed Concurrently with Plaintiffs' Statement of Genuine Issues]

## I.

## INTRODUCTION

The entire thrust of Defendant Robert G. Holmes, Jr.'s ("Holmes") Motion for Summary Judgment is that the conduct of Defendant Joseph A. Lugo, Jr. ("Lugo") and other defendants were independent forces for which Holmes cannot be accountable. The facts, as hereinafter

set forth, show that Holmes is not only culpable, but along with defendants Seymour Vigman ("Vigman"), Isadore Diamond ("Diamond"), Martin Blumenthal ("Blumenthal"), Lugo and Rodger Garrity ("Garrity"), was one of the principal characters in the scheme to manipulate Aero Systems, Inc. ("Aero Systems") and prices of other over-the-counter securities.

Lugo did not act alone. Rather, the scheme, as will be shown, required and had participants each with distinct roles and responsibilities, with each profiting in his own way, and each contributing to the collapse of First State Securities Corporation ("FSSC") and Joseph Sebag Incorporated ("Sebag").

## II.

## STATEMENT OF BACKGROUND AND FACTS

### A. HOLMES IS LIABLE FOR DAMAGE CAUSED BY THE MANIPULATIVE SCHEME

As more fully set forth below, Holmes was a long-time friend and confidant of Lugo and Vigman. His relationships with Lugo and Vigman enabled him to successfully manipulate Aero Systems and Bunnington stocks. More importantly, however, the Aero Systems manipulation was only a component of a larger scheme to manipulate six different securities. The manipulative schemes culminated with the demise of FSSC and Sebag, thus causing harm to the Trustees and SIPC.

The manipulated securities were Aerosonic, Aero Systems, Bunnington, Creditbank, Dash and Osrow. Holmes' involvement with the grand scheme included the following acts: (1) the manipulation of Aero Systems' stock which benefitted Vigman, who sold out large positions at the precise moment that false press releases caused the price



to escalate. Lugo then resold the Aero Systems stock which harmed FSSC, when Lugo used profits from Aero Systems sales to increase FSSC's inventory position in Bunnington and Aerosonic stock, in a further attempt to manipulate those stocks for the benefit of Holmes, among others; (2) the utilization of proceeds from the sale of Aero Systems stock at manipulated prices to purchase Bunnington stock, when Vigman failed to demand immediate payment. This created a false cash supply at FSSC, enabling Lugo to buy up Bunnington and Aerosonic stock, thereby creating the appearance of market activity when, in fact, there was no *bona fide* market activity in Bunnington or Aerosonic stock; (3) the direct participation in a manipulation of Bunnington stock through the dissemination of a false and misleading press release to a stock broker; (4) the direct manipulation of Bunnington stock through a pattern of trading consisting of purchasing Bunnington stock at FSSC in relatively large blocks, and selling the stock at other brokerage houses in small increments to create the appearance of a wellspread market that did not exist; (5) the parking of 5,000 shares of Bunnington stock at a crucial time when Lugo needed to get Bunnington stock off FSSC's books thereby enabling FSSC to stay in business past the point of a net capital deficiency; (6) the agreement of Holmes to allow his company, Aero Systems, to serve as a retail outlet for a computer marketed by Dash Industries, thereby enabling Dash Industries to make false and misleading statements regarding its business and prospects.

Plaintiffs submit that Holmes was a knowing participant in the manipulative scheme to inflate the price of all six securities. Holmes' knowledge of the scheme's scope and complexity is not only evident in the acts identified above, but can also be inferred from his long-standing relationships with other players in the scheme, and the

personal benefit he realized from marketing securities. Those relationships with his co-defendants are described below.

Plaintiffs seek to prove that the course of Holmes' conduct, stretching back to the mid 1960's, shows a method of operation that became highly sophisticated by 1980-1981. Further, the relationships of many years and acts of many years ago indicate the formation of a conspiracy to manipulate securities that continues to this day. Moreover, many of the activities outlined below are predicate acts under the Racketeer Influenced and Corrupt Organizations Act.

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K. THE CD-3000 WAS USED BY HOLMES, VIGMAN AND OTHERS BY USE OF FALSE STATEMENTS, TO CREATE INVESTOR INTEREST IN AERO SYSTEMS

1. Aero Systems Acquired the "World Wide Marketing Rights" to the CD-3000

The CD-3000 "Fuel Management Computer" was designed as a "pilot aid" (Hayden pp. 17-18) for general aviation aircraft operators (*e.g.*, twin Cessnas, commuter planes, etc.) (Hayden p. 21). The CD-3000 was not originally designed as a fuel savings device (Hayden p. 134), despite the fact that Holmes built an advertising campaign around the device as a system for saving fuel (Hayden p. 136).[47] In fact, the CD-3000 displays gross aircraft weight, fuel remaining, and is not a "computer" in any real sense. The CD-3000 is no more useful for fuel

[47]Hayden thought of the device more of a range extender than as a fuel savings device (Hayden pp. 134-135). Thus, the CD-3000 wasn't "designed" to "save fuel" as Holmes claimed later.



saving than an aircraft manufacturer's performance chart (Davies pp. 149-150).[48]

Holmes claims that he first heard about the CD-3000 from Charles Hayden ("Hayden") of Colt Electronics, Inc. ("Colt") in February or March 1980 (Holmes pp. 10-12).

Holmes had a "personal desire" to do something with the CD-3000 (Holmes pp. 29-30).[49] Vigman shared Holmes' enthusiasm for the CD-3000 (Holmes p. 31). Holmes discussed with Vigman the possibility of merger between Aero Systems and Colt (Holmes p. 16). However, Vigman advised Holmes not to buy Colt, but to purchase the rights to the CD-3000 instead (Holmes p. 30).

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2. The proper market for the CD-3000 was limited to business jets

The CD-3000 was the idea and invention of Hayden, employed by Colt (Hayden, p. 17). Hayden was an experienced business jet pilot and had a lengthy history in the aircraft industry (*Id.*, pp. 11-18). He had been a member of the National Business Aircraft Association since its inception in 1949 (*Id.*, p. 261).

Hayden handled the marketing for Colt (*Id.*, pp. 137-138). He believed the market for the CD-3000 would be small (*Id.*). He believed that the market was very limited for other than business jets (*Id.*, p. 69).

[48]Continental Airlines' pilots rejected the CD-3000 since "the computer wasn't doing anything different than what one of the flight crew members would do with a calculator" (Kightlinger, pp. 29-30).

[49]It is the opinion of John Torkelsen, one of plaintiffs' experts, that the stock of Aero Systems was manipulated (Torkelsen Decl. ¶ 16).

Further, Hayden believed the CD-3000 was not of practical use in the general aviation field (*Id.* p. 69).[51] Hayden was aiming at the business aircraft market (*Id.*, pp. 21-22). He wanted to keep the price low enough to attract commuter aircraft and he did not believe that the CD-3000 would ever be a seller in the airline market (*Id.*). He did not pursue the airline market because he saw no potential for sales in it (*Id.*, pp. 139-142). He had looked at the airlines and found a complete lack of interest (*Id.*). He had conducted market studies by conversing with pilots from all over the world (*Id.*, p. 52). Hayden estimated that Colt would get CD-3000 sales involving 10% of the existing executive aircraft in operation, and approximately 25% of the new executive type aircraft being sold (*Id.*, pp. 53-54). The estimate was based on his examination of the market and of the planes in the market (*Id.*). He estimated that sales would be 35-50 per year (*Id.*).[52]

Holmes told Hayden how much he wanted to market the CD-3000 under the Aero System's name (*Id.*, p. 61), and that Holmes had expressed that he thought it "would be a great thing for the airlines" (*Id.*, p. 64).[53] However, Hayden told Holmes before Holmes acquired the rights to

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[51]The term "general aviation aircraft" refers generally to all aircraft other than commercial aircraft. (*See* Hayden, p. 69).

[52]Hayden's forecasting proved both right and wrong. First, he was right about the market; only 7 were sold by Holmes to airlines between April 1980 and December 1987 and *none* were sold to general aviation aircraft (Exh. 5285). Hayden was wrong, however, about how many would be sold. In eight years, Aero System sold only *90* CD-3000s, which is only a little over *11* per year — less than one a month (Exh. 5284).

[53]Holmes admits that before he signed the agreement with Colt, no CD-3000 had been sold to any commercial airline (RFA 260).



the CD-3000 that he (Hayden) did not think it would ever be a big seller (*Id.*, p. 137). Hayden expressed extreme skepticism about the arrangement (*Id.*, pp. 61-62). Hayden told Holmes in 1980 that Airlines' maximum efficiency occurs at between Mach .74 and .76 but that airlines operate between Mach .80 and .82 despite fuel considerations (*Id.*, p. 144). Hayden told Holmes that airlines know how to save fuel but don't because of time constraints and that sales to airlines "was a complete and total dead issue." (*Id.*, p. 144; 267-268).[54] Also, Lynn told Holmes that the application of the CD-3000 was limited to business jets, and was only "remotely" applicable to commercial aircraft (Lynn, p. 91). When Holmes sensed Hayden's unenthusiastic reception, Holmes offered Hayden 5,000 shares of Aero Systems stock "if you don't raise too much fuss with Bob (Lynn) to go ahead with this." (Hayden, p. 62).[55]

Aside from the idea of selling to the airlines, Holmes never expressed a marketing concept to Hayden except

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[54]Holmes admits that Hayden "may" have told Homes that the commercial airlines were not the proper market for the CD-3000 (Holmes p. 284). Holmes admitted that international airlines were his principal target (Holmes p. 113). He also admitted that he knew that the device could not be sold to single engine planes (Holmes pp. 85-86).

[55]While Aero Systems' files are replete with "incentives" or "inducements" to airlines to buy or test the device (facts which are too numerous to detail here, but facts with which Aero Systems will not disagree), the bribe to Hayden is only one of two actual known bribes made by Holmes in his desperate efforts to sell the CD-3000 to an airline. In the late spring of 1982, Holmes attempted to bribe Frederick Lind, the Vice President of Engineering and Quality Assurance of Continental Airlines, to enter into "a joint advertising campaign" (Lind Declaration). While this occurred after collapse of the brokerage houses, it is compelling evidence to show that the airlines had not been the proper market, and that Holmes knew it.

that Holmes intended to sell through dealers (*Id.*, pp. 69-70).

Indeed, before Holmes acquired the "worldwide distribution rights" to the CD-3000 he had had no market study done (Holmes, p. 43).[56] Holmes could have cared less; the real reason that Holmes wanted the rights to the CD-3000 was best expressed by Holmes to Hayden when Holmes was trying to induce Hayden to accept 5,000 Aero Systems shares for not raising a "fuss": "Mr. Holmes expressed to me that, *when he made his pitch with all his people, that the stock would go up sharply*" (Hayden, pp. 179-180) (Emphasis added).

Holmes, however, didn't listen, didn't investigate the market and didn't care what the inventor knew the market for the CD-3000 to be. He had a different agenda.

3. Holmes, Vigman and Others Started to Make the "Pitch" and Misrepresented the Capabilities and the Market of the CD-3000

   a. Holmes and Vigman Immediately Began Selling the Device to the Stock Market: They Used Porter LeVay & Rose

Rather than immediately investigate the market for the CD-3000 because of Hayden's caution, or even try to sell

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[56]Holmes testified that he didn't need a market survey (Holmes, p. 2077). He should have done one, a point that is made quite clearly by Robert Litle, "Special Representative, Aero Systems Aviation Corp" in his memorandum to Holmes dated August 21, 1981 (Exhibit 3869). Litle told Holmes that he has "continued my market analysis of airline customers" and that, while the survey "is not yet complete" fully 65% out of 407 aircraft "cannot be fitted with the CD-3000 at this time" (*Id.*). Litle joined Aero Systems on June 21, 1981 (Exh. 8005), was with Aero Systems for two years and his title was approved by Aero Systems (Holmes, p. 2082).



the device to the airlines, Holmes and Vigman immediately set out to "sell" the CD-3000 to the stock market.

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   b. Vigman Was Heavily Involved With Holmes in the Promotion and Publicity Program for the CD-3000

PLR started its publicity campaign for Holmes.[60] Its activities included, *inter alia*, introducing Aero Systems to the financial community, preparing and distributing releases to the financial community and the business, financial and trade press, placing articles in the financial publications, arranging conferences with financial columnists, updating market makers and discussing Aero Systems with numerous members of and analysts in the financial community (Exhs. 953; 959; 971; 972; 973; 978; 991; 994; 999; 1004; 1007 and 1008).

Shortly after the first press release on April 1, 1980, Vigman and Holmes didn't like the kind of exposure the CD-3000 was getting. Porter prepared a memo to Holmes[61] as to how PLR would handle Aero Systems releases in response to Vigman and Holmes' "rather strong comments about our system, the way we were

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[60]PLR's distribution process included sending all releases to the Wall Street Journal office in Atlanta to get on the Dow system, and were distributed to Reuters, the New York Times and onto the PR Newswire. They were also mailed out to a mailing list made up of brokers and money managers (Porter, pp. 55-56).

[61]Porter wrote Holmes that all releases were to be prepared by PLR from information supplied by Aero System, then reviewed by Aero System and released by PLR with Holmes' approval (Exhibit 956). Porter testified that this procedure was followed (Porter p. 59, ll. 16-18). Thus, PLR released nothing without Holmes' approval and Holmes is personally responsible for the releases and their content. Holmes frequently sent the releases to Vigman for review (Vigman p. 443-444).

making releases, and if I am not mistaken, this was because they felt the release on the CD-3000 did not get enough pick-up in the media" (Porter p. 58; Exh. 956).

Porter had a number of discussions with Vigman about PLR's promotion of Aero Systems stock and the CD-3000 (Exh. 953, p. 407-0098; Exh. 973, p. 407-0002). Vigman and Porter began to have words with each other because of Vigman's discontent with the way the material was distributed, and Porter kept telling Vigman that Vigman wasn't the client (Porter, p. 58, ll. 19-25). Vigman threatened Porter that he, Vigman, was "...a rather large shareholder and I have a lot invested in this company." (*Id.*, p. 59,).[62] Porter told Vigman that he wouldn't discuss it with him but would go through Holmes, but then things started to get rocky. Porter had problems with Holmes because of the "back-biting that Sy Vigman started to do in our firm." (*Id.*, p. 59). Holmes also told Porter that Vigman was unhappy. (*Id.*, p. 59).

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[62]Vigman also privately told Garrity that he, Vigman, was either the first, second or third largest shareholder of Aero Systems (Garrity, p. 23). Vigman privately told Eiseman that he was the largest shareholder of Aero Systems (Eiseman, pp. 79-80, 11/22/85). Plaintiffs have been unable to locate any public disclosure by Holmes or Aero Systems of Vigman's substantial stock holdings in Aero Systems, of Bigman's criminal past, of his extraordinary close association with Holmes, of his claim of being a director of Aero Systems or his pervasive control and influence over Holmes. Indeed, his shadowy presence is hidden by public disclosures to the contrary. In Bunnington's Form 8-K for March 31, 1978 relating to the Springwater sale to Bunnington, Vigman publicly disclaimed owning any Aero Systems stock and told the public that he didn't control Nettie Vigman's 206,925 shares, his two childrens' 120,000 shares or his son-in-law's 236,925 shares (a total of 11.49% of Aero Systems) (Exh. 4105). Note surprisingly, Holmes certified that the Vigmans were not a control group. (*Id.*).



After Porter told Vigman that he wouldn't deal with Vigman, Holmes called Porter and told Porter that Vigman wanted to talk to Porter about what PLR was doing (*Id.*, pp. 91-92). Porter was in the position that since Holmes demanded that Porter talk to Vigman, he did it. (*Id.*). Vigman wanted to know what PLR was going to do for the next several months for Aero Systems "to get the company more exposure" (*Id.*). Porter told Vigman that there were no specifics because he was waiting for dates from the financial community for Holmes to take him on the road to meet brokers (*Id.*). Vigman told Porter that he, Vigman, wanted to make sure that PLR wasn't letting down in their activity "... because (Vigman) *wanted the stock higher* because he thought it was worth a hell of a lot more than it was at this particular time" (*Id.* (emphasis added)).[63]

In a July 1980 conversation, Vigman told Porter that he was following Porter's activities, knew what Porter was doing and was reviewing it (Porter, p. 100). Vigman warned Porter: "I am watching what you are doing (Porter p. 101)."[64]

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[63]Aero System's stock price had gone from a low of $2.78 bid/$3.25 ask in April 1980 to a high of $4.00 bid/4¼ ask in July, 1980 (Foley Decl. ¶ 136).

[64]It's very apparent that Holmes *wouldn't* move without Vigman's approval. Holmes told Porter in about July that he, Holmes, was sending copies of PLR's monthly activities reports to Vigman (Porter, p. 100; Holmes, p. 324).

* * *

2. Holmes, Vigman and Porter, LeVay & Rose Issue False Press Releases

c. April through June 1980

Holmes was responsible for the preparation, content and distribution of Aero Systems' press releases (Holmes, p. 3025). Nothing went out from the company without Holmes' approval (see fn. 61, *supra*). Holmes discussed press releases with Vigman (Vigman, pp. 443-444); he sent press releases to Lugo (Holmes, pp. 109-276). There is no evidence anywhere that Holmes ever modified, changed or retracted any press release, news article, quotation, shareholder letter, annual report or other public document, once that item had been publicly disseminated.[70]

Holmes' very first press release on April 1, 1980 regarding the CD-3000 (Holmes, pp. 658; Exh. 947) states that "The potential market for this much needed new product includes all multi-engine jet, turbo prop and piston aircraft in the world." Thus, Holmes included all of the world's airlines and all of the world's general aviation aircraft in his "potential" market, having done no market study, having no test results and having been told by the inventor that the market Holmes described to the public is not the market for the product.[71] Holmes also states

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[70]Holmes testified that he tried it once, but that there's no way "to get these things changed" (Holmes pp. 379-380).

[71]Both Vigman and Holmes gave input to Porter for the press release (Porter, p. 38) Vigman and Holmes told Porter that the CD-3000 was "designed to reduce fuel consumption by 15%" (Porter, p. 47) and was reflected in the first draft of Porter's first press release (Exhibit 948). There is no basis anywhere for a claim of 15% fuel savings. In fact, at the time of the release, neither Holmes nor



that he plans to market through a "selective network of dealers. Holmes didn't sign up his first dealer for the CD-3000 until September 14, 1981 (Exhibit 8001), eighteen months after he signed the CD-3000 agreement.

On April 23, 1980 (a day after the final agreement was signed between Colt and Aero Systems), Holmes announced that Aero Systems planned to lease the unit "to commercial and business aircraft operators . . . in exchange for a percentage of actual fuel savings" (Exh. 5203). Holmes then stated that "airlines alone will spend more than $30 billion for fuel this year" (*Id.*) The obvious effect sought was that Aero Systems would get, by its leases, that percentage of the $30 billion of fuel saved (Holmes, pp. 105-106). By analyzing Exhibit 5284 which lists all CD-3000 sales and the price paid, through November 1987, it is clear that Aero Systems never entered into any such lease. There was no public announcement that Aero Systems' "plan" was not implemented.

On April 28, 1980 Holmes prepared and sent a letter to Aero Systems' shareholders which states, *inter alia:*

1. "[W]e are very pleased . . . to inform you of a very exciting new development that could be the most significant event in our history."

2. "[W]e are entering an exciting new market . . ."

3. "[P]resent business jet users have indicated fuel savings to be in the area of 10%."

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Colt *had* any empirical written test results concerning what or what not the CD-3000 would save (Lynn, pp. 87-88; Holmes, pp. 46-47), and Holmes knew this (Lynn, pp. 89-90). The actual first press release didn't include any reference to any alleged fuel savings. The fact that Holmes and Vigman told Porter that the device saved 15% fuel, however, clearly shows the two of them creating "percentages" out of whole cloth.

4. "[O]ur initial market includes installation in the 50,000 plus multi-engine jet, turbo prop and piston aircraft currently in operation . . ."

5. "[W]e are currently discussing a leasing proposal with one of the major air carriers . . . in exchange for a percentage of actual fuel cost savings."

6. "[T]he potential savings could be a fantastic amount since the world's airlines are expected to spend more than $30 billion for fuel this year, a third of that amount by the U.S. Airlines."

7. "[W]e are thrilled with the added potential of this exciting new high technology product that could be greater than everything we have done throughout our entire history." (Holmes, p. 108; Exh. 5204)

The non-existent "market" identified by Holmes consisted of over 50,000 aircraft of all kinds through the world. There are no facts that Holmes possessed that every aircraft in the world could or would use the CD-3000.[72] Holmes testified that he merely pulled the figure out of Jane's All the World Aircraft (Holmes p. 109). However, there is still no support for Holmes' claim that all the world's aircraft could or would use the device (Declaration of Davies, ¶¶ 3-5). Further, Holmes doesn't disclose that Colt's capacity to produce the CD-3000 is

[72]In fact, Davies testified that general aviation aircraft operators (*e.g.* twin piston, turbo-prop, etc.) would not be interested in the CD-3000 because of its high relative cost (Davies, p. 107), because the cost of fuel is a very small part of the cost of small plane ownership (Davis, p. 69), and because fuel quantity, fuel flow, and gross weight information is available with less expensive devices (Davies, p. 107). And, as Airlift International's Robert Sovacool observed, all new generation jets have more exotic fuel management systems as original equipment (Sovacool, pp. 24-25; *See also* Davies Declaration, ¶¶ 3-5).



extremely limited.[73] Holmes doesn't disclose Colt's reservations as to the CD-3000's limited market appeal, or the inventor's warning that airlines won't use it.

i. *Holmes' Claim That The CD-3000 Saved 10% Fuel Consumption Was False*

Holmes' representation that "business jet users have indicated fuel savings to be in the area of 10%" was false and known to be false at the time it was published.

Holmes admits that there were no written test results of the CD-3000 before he signed the agreement with Colt (Holmes, pp. 46-47). He never received *any* written test results from anyone at Colt (Holmes, p. 48). Holmes admits that the first written test results of any tests on the CD-3000 he or Aero Systems received were in July of 1981 (Holmes pp. 444; 1910-1911; Exh. 1039).

Holmes claims that Lynn and Hayden of Colt *told* him that fuel savings were in the area of 10% (Holmes, p. 117), and that Hayden had told him that Smith (a pilot for Landis Tool) was "getting about 10%" (Holmes, p. 120).

However, Lynn denies that there are or ever were any empirical test results from the CD-3000, or that he ever gave any to Holmes (Lynn, pp. 110-111). Lynn doesn't even recall any customer telling him that there was a percentage fuel savings by using the CD-3000 (Lynn,

[73]Lynn testified that in 1979-1980 Colt had about 10 people of whom three were in production (Lynn, p. 20). In 1980, Colt had only 7,500 square feet and "probably five" people in production (Lynn, p. 21). Colt maintained a "very small" inventory of three to five CD-3000s, and after the Aero System agreement they produced CD-3000s on an "as needed" basis (no inventory was maintained) (Lynn, pp. 57-58). It took Colt three (3) months to produce a CD-3000 from date of order and, all things being equal, Colt could only have produced "several hundred" per year (Lynn, p. 58-59).

p. 31). Lynn never even knew of a percentage savings or fuel maximization, nor did anyone else to his knowledge (Lynn, pp. 28-29). As Lynn stated: "We have no idea what the fuel management computer can save a person in economy" (Lynn, p. 28). Lynn does not recall any discussions with Holmes or Vigman during his March 1980 trip to Miami related to percentage of fuel savings, and at that time there were no test results (Lynn, pp. 87-88). Hayden does not remember "ever saying 10%" (Hayden, p. 42).

Lynn says that Hayden was bandying about the 10% savings numbers, but that there was no test data to support it (Lynn, pp. 89-90), and if percentage figures were passed on to Holmes, Holmes was told that there was no test data to support them (Lynn, p. 101). Lynn further testified that any percentage figure was "pure speculation" and Holmes was told that it was (Lynn, pp. 100-101).

Smith (a pilot at Landis Tool, one of the two business jet operators who had installed the CD-3000 before Aero Systems entered into the agreement with Colt) never represented to anyone at Aero Systems or to anyone on behalf of Aero Systems that fuel savings were possible with the CD-3000 (Smith, p. 40). As a matter of fact, Landis Tool bought the device because it provided more information; they did not buy it to conserve energy, and never used it to conserve energy (Smith, pp. 45-47).

There is no evidence anywhere that Holmes obtained testimonials from "business jet users" that the device saves 10% of fuel before Holmes made that claim in his public announcements.[74]

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[74]The totality of the shareholder letter is not only abnormally hyperbolic, but gives the potential stock purchasers the distinct impression that Aero System, by its "leasing" arrangement to a U.S. airline, would garner earnings equivalent to at least 10% of 10 billion dollars (one third of the $30 billion spent on fuel by the world's airlines).



ii. *Holmes Failed To Disclose Significant Limitations On The CD-3000's Capabilities And Usefulness*

Holmes also failed to disclose to the public the technical capabilities, or lack thereof, of the CD-3000. Holmes failed to disclose that:

(1) Reservations expressed by the inventor and manufacturer regarding the market Holmes was claiming (Hayden pp. 21-22; 141; Lynn, pp. 90-91);

(2) The use of the CD-3000 is very limited. The CD-3000 only is capable of use on the "cruise" portion of the flight, and thus the interest of any airline depended on the "block times" of the airlines' flight schedules.[75]

(3) At the time of the agreement between Colt and Aero Systems, the CD-3000 was not capable of being used on aircraft weighing over 100,000 pounds. (Lynn, pp. 114-116) and was not available in a model for such use until six (6) months after the agreement was signed (*Id.*).[76]

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[75](Hayden pp. 267-268; Exh. 2406).

[76]Virtually all of the commercial airlines and all cargo carriers operated in the time frame from April 1980 to July of 1981 operated at gross weights in excess of 100,000 pounds. (Declaration of Davies, ¶ 2). These aircraft included the following makes and models: Lockheed L-100, L-1011; McDonnell Douglas DC-8, DC-9, DC-10; Boeing 707, 727, 737, 747. *See also* Holmes Response to RFA 652. The CD-3000 couldn't be installed on aircraft in excess of 100,000 pounds until at least September, 1980 (Exh. 2413).

(4) Prior to the sale of the CD-3000 the FAA had to issue a Supplemental Type Certificate ("STC") for use of the device on any given type aircraft for which it was purchased. (Sovacool, p. 56). From the time of the application until the STC is obtained can be from three to six months (Hayden, pp. 34-35).[77]

(5) The use of the device would slow a commercial jet down and that commercial airlines, as Hayden warned are tied to a tight schedule and would not adopt a device that interfered with that schedule;[78]

(6) Use of the device depended heavily on pilot acceptance and, as pilot Smith said, in order to utilize the device, one would have to operate outside the flight manual; "Flight manual is Bible. You don't ever do that" (Smith, pp. 36-38);[79]

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[77]Once an application for an STC is made, a FAA inspector must issue a Type Inspection Authorization, and then a FAA inspector has to test the unit for safety and compatibility with that specific type of plane (Hayden, pp. 30-31). After all of these steps are completed, then the FAA will, in time, issue the STC (*Id.*). Only two types of business jets had CD-3000 STC's at the time Holmes signed the agreement with Colt (RFAs 167-168). In fact, only four STC's had been issued prior to mid-1982 (Exh. 2402).

[78]*e.g.*, American Airlines advised Holmes in (August 6, 1981) that they considered time to be more critical to their operation than fuel savings. (Holmes, p. 2154; Exh. 3882).

[79]Roy Johanson, Aero System's VP-Marketing, who reported directly to Holmes (Johanson, pp. 13-14), testified that the CD-3000 was less successful with airlines than business jets due to poor pilot acceptance (Johanson, pp. 77-78). Pilots were not inclined to use the CD-3000 because of their cockpit work load. Johanson discussed these opinions with Holmes, but Holmes thought he could overcome lack of pilot acceptance through "marketing" (Johanson, pp. 80-82).



(7) The lack of capabilities of Colt to manufacture the CD-3000 in the gross numbers of the "market" that Holmes was leading the public to believe existed for the device.[80]

On the same day of Holmes' shareholder letter the same material was published by the National Quotations Bureau, Inc. (Exh. 116).[81]

On June 9, 1980, Holmes caused to be published an advertisement in Barron's which said "Initial results from business jet users indicate fuel savings to be in the area of 10%" (Holmes, p. 1695; Exh. 3806)[82]

d. July 1980

During April, May and June 1980, Aero Systems stock price remained fairly level from a low 2⅞ bid/3¼ ask to 4 bid/4⅜ ask (Foley Decl. ¶ 135). It's during this time that Holmes and Vigman were expressing dissatisfaction with PLR's program.

On July 1, 1980 PLR prepared and sent Holmes a draft of a "proposed fact file" which was "intended to outline

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[80]*See* footnote 73, *supra*.

[81]Holmes admits that he periodically sent information to the Grinde Organization (NQB publisher), but does not know if he sent this to the Grinde Organization (Exh. 116; Holmes pp. 135-137).

[82]The use by Holmes of the plural "users" is not just disingenuous but is a deliberate misstatement calculated to deceive the public into thinking that the business jet market was crowded with the devices. Holmes only claims to have spoken to Smith of Landis Tool (*supra*, p. 62) and Lynn and Hayden of Colt (*supra*, p. 62). Smith (who denies he told Holmes anything about a 10% savings) is the *only* business jet "user" who could have been Holmes' source. Further, by use of "initial results," Holmes is telling the public that there were some tests conducted on the CD-3000 giving "initial results." There were no tests and no "initial results."

Aero's operations succinctly for members of the financial community" (Porter, p. 74; Exh. 969). Holmes redrafted the "fact file" and sent it back to Porter. (Porter, p. 76; Exh. 969, pp. 407-0563-0566). Porter redrafted it again, taking out some of what Holmes had inserted and finalized it (Porter, p. 77; Exh. 969, pp. 407-0567-0573). The "fact file" and Holmes' revisions are very significant.

First, Holmes reiterates the false claim that "initial results from business jet users indicate fuel savings to be in the area of 10%" and the false claim that the initial market for the device is "50,000 + multi-engine jet, turbo prop and piston aircraft . . ." These misrepresentations stayed in the final "fact file."

Second, Holmes added that "As of June 30 (1980) Aero Systems met the final requirement of the Federal Reserve Board to qualify its stock for sale on margin and expects to be included in the next qualified list to be published in October. This factor alone should greatly enhance the value of the stock" (Exh. 969 at p. 407-0565).[83] This was included in the final "fact file" except for the last sentence (*Id.*, 407-0561); while not expressly said to the public, the last sentence clearly shows that qualifying for margin was part and parcel of Holmes, Vigman and Lugo's carefully conceived plan to raise the Aero Systems stock price without any underlying economic justification.

Third, Holmes adds "We see Aero Systems as the best buy in the market today for capital appreciation and would not be surprised to see the value of this stock triple before the end of this year" (*Id.*, p. 407-0565). While this was muted substantially by Porter in the final version

[83]The Federal Reserve Board approved Aero Systems' stock for sale on margin in early October, 1980 (Exh. 123).



(*Id.*, p. 407-0573), Holmes' unsupported enthusiasm and actual motive underlying the acquisition of the marketing rights to the CD-3000 is abundantly clear.

Finally, Holmes recklessly, if not falsely, projects sales and earnings of an unprecedented and unsupportable amount attributable, in part, to the CD-3000. Porter's original draft of the "fact file" (*Id.*, pp. 407-0558-0562) says nothing about Aero Systems' earnings. In Holmes' redraft for PLR's use in the fact file (Id., pp. 407-0563-0566 at p. 406-0563), Holmes wrote:

> Aero Systems Inc., is the most exciting situation that (Porter LeVay & Rose) have ever had to work with. (PLR) believe(s) the Company is on the verge of a major breakout in both sales and earnings, that could exceed $50 million in sales and $1.50 to $2.00 in earnings by 1983 as a result of:
>
> • • •
>
> c. Sale and lease revenues from the Company's unique new Fuel Saving Computer which potentially could dwarf the Company's entire operations.

Holmes' predictions appeared in the final "fact file" (Exh. 970, p. 407 0153).[84] The final version of the "fact file", together with Holmes' letter to shareholders was sent by mail to approximately 5,000 members of the financial community (Porter pp. 81-82; Exh. 970).

PLR's report had the desired effect. As Porter reported to Holmes on September 22, 1980 concerning PLR's August 1980 efforts: "The report was widely distributed

[84]Aero Systems' *actual* sales and earnings were:

| | 1981 | 1982 | 1983 |
|---|---|---|---|
| Sales ..... | $14,487,016 | $17,163,786 | $26,918,626 |
| Earnings ..... | .06 | .10 | .21 |

Aero System 1983 Annual Report (Exh. 5261)

. . . We have received numerous responses from the report and have seen an increase in the stocks' activity . . . *Roger Garrity* of Investors Financial Services, Inc. and *Joe Lugo* of First State Securities *both told us that the interest in the stock is being generated from the report"* (Exh. 978) (emphasis added).[85]

Also, in July 1980, Holmes was interviewed by Martin Merzer of the Miami Herald and told Merzer the falsehood that "Our tests show (the CD-3000) can result in fuel savings of up to 10%" (Exh. 119; Merzer pp. 8-9). Aero Systems had received no written test results (RFA 945).[86]

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In March 1981, in the ABD, Aero Systems placed an ad claiming "up to 10% fuel conservation" (Exh. 5234). Smart Money published an article in its April 1981 issue stating that "[w]ith the CD-3000 a pilot can save from 4% to 16% (of fuel) . . ." (Exh. 137). Also, in an article appearing in the OTC Review in July 1981, it's again reported that the CD-3000 ". . . is designed to reduce an airplane's fuel consumption by as much as 16 percent . . . "(Exh. 5244A). On June 17, 1981 Holmes released over PR Newswire that "The CD-3000 . . . *can* save up to 10% of the fuel consumption . . . "(Holmes, pp. 500-501; Exh. 5242) (emphasis added).

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[85]During this time period, PLR, *inter alia*, prepared and distributed to the financial community at least four releases on the CD-3000 (Exh. 953, p. 407-0096; Exh. 959, p. 407-0080; Exh. 971, p. 407-0028).

[86]Aero Systems claims to have conducted tests, but the tests didn't provide any percentage of fuel savings because Aero Systems wasn't "actually using any fuel" (Holmes pp. 185-186).



e. Holmes Released False and Misleading Information Regarding Airlift International

On January 27, 1981 Holmes issued a press release stating that Aero Systems had signed an agreement with Airlift International, Inc. ("Airlift"), describing Airlift as the "first commercial airline user" of the CD-3000 (Exh. 5226). Holmes claims that "Airlift will also provide Aero with documented fuel savings operating results" (*Id.*). This announcement appeared in Barron's on February 2, 1981 (Exh. 5227), the February 9, 1981 Aviation Week publication (Exh. 5232), and Fortune Magazine on March 9, 1981 (Exh. 5235).

Holmes failed to disclose that all Airlift flew as a "commercial" airline were freighters (Sovacool, p. 57) and that the CD-3000 was going to be "tested" on Airlift's long distance airplane (Sovacool, pp. 57-58). He did not disclose that such "tests" on a single aircraft vary not only with respect to the types of aircraft involved but aircraft within the type itself (Sovacool, pp. 123-124). He failed to disclose that loss of time caused by use of the CD-3000, a serious concern of passenger airlines, was of no concern to Airlift (Sovacool, p. 164). He failed to disclose that slowing cruise time[100] of an airline aircraft increases crew and maintenance costs, and that as incremental costs approach the marginal cost of fuel, the value of the CD-3000 diminishes (none of which was considered by Airlift or in its report) (Sovacool, pp. 130-131). Finally, he failed to disclose that the pilot can obtain the same results by using a flight plan as from using the CD-

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[100]Cruise time is the time that you enter into a steady state operation from the top of the climb until the top of the descent (Sovacool, pp. 128-129).

3000; the CD-3000 only makes the information more convenient (Sovacool, pp. 82-83).

Holmes then sent a letter to shareholders on March 16, 1981 telling them that Aero Systems is "currently installing [the] CD-3000 . . . on our first large commercial jetliner" (Holmes, p. 383; Exh. 1011). He makes the same omissions, and additionally, chooses not to name Airlift International. He finally acknowledges that "pilot acceptance is the key" to the success of the device (*Id.*), one of the cautions told to him by Hayden a year before.[101] Holmes continues to emphasize that the company is "on the verge" of success; *i.e.*, " . . . [t]he documented results are expected to be the trigger to volume sales and leases to the world's major airlines. We are now more confident than ever about the success of our CD-3000 . . . and feel we are on the verge of a major breakthrough" (*Id.*).

On May 7, 1981 Holmes issued another press release (Exh. 1038).[102] Holmes reveals that "preliminary indications" of the testing by Airlift "appear to be quite significant" (*Id* ). He "quotes" Sovacool to the effect that he, Sovacool, has recommended that Airlift "outfit the entire

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[101]The prospect of "real" test data from Airlift International also coincided with Holmes' discharge of PLR on April 20, 1980 (Exh. 1009). It's submitted that Holmes didn't need PLR's further assistance or costs in disseminating Holmes' phoney statistics.

[102]On May 1, 1981 — six days before this first public release which in any way relates to any actual testing, or whether or not the tests were "encouraging," Moore Schley distributed a report to its brokers stating that Airlift test results are "quite encouraging" and that "[f]inal [test] results should be available shortly" (Exh. 139). That was not public knowledge on May 1. Regardless of whether or not the statements were true, it appears that Holmes passed on inside information which was used by Moore Schley.



fleet" with CD 3000's.[103] The letter further states that the tests have not been completed, and Holmes says the tests are scheduled to "continue for another week . . . " after which the data must be "consolidated and compared with prior fuel consumption . . . in order to document . . . fuel savings." The alleged test data on which the final report was based was already completed by this date; the final report shows the "testing" took place between March 15 and April 15, 1981 (Sovacool, p. 120; Exh. 1039). Thus, Holmes misrepresented the extensiveness of the testing, and that it was to continue.[104]

In another letter to shareholders on May 18, 1981, Holmes repeats Sovacool's "quote" and states that Sovacool says the device "does more than [was] anticipated" (Holmes, p. 486; Exh. 145). In fact, Sovacool testified that he had no way to anticipate any particular percentage of fuel savings (Sovacool, p. 32).

The Airlift International report was released on July 14, 1981 and was signed by Robert Sovacool, Airlift's Director of Flight Operations (Exh. 1039). Holmes drafted both Sovacool's forwarding letter and the report.

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[103]The fact that the "entire fleet" consisted of a total of nine planes (Sovacool, p. 58) was not disclosed. Also, the "quote" by Sovacool was written by Holmes, not Sovacool. (Holmes, p. 1907).

[104]Neither Aero Systems nor Holmes have produced any "test" results, raw data, calculations, compilations, analyses or other documents to back up the Airlift "tests". Sovacool says they were given to Aero Systems (Sovacool, pp. 83-84; 87; 104-105). The documents Sovacool says were given to Aero Systems were not produced by Aero Systems in this litigation despite repeated efforts to get them (Taylor Decl. ¶ 6). The fact that documents of such obvious importance to Holmes were not produced raises serious questions not only as to the validity of any interpretation of their results, but of their very existence.

and Sovacool signed them (Holmes, pp. 1911-1912; 1914). Holmes can't point out any changes made by Sovacool (Holmes, p. 1915). Holmes had first received the report in June (Holmes, p. 1911). This report, which Holmes calls the "Airlift test package" (Holmes, p. 1913) was the report which Holmes sent to other airlines (Holmes, pp. 1912-1913).

On July 24, 1981 Holmes sent *another* letter to shareholders extolling the Airlift test results (Holmes, p. 517; Exh. 149). He states that "even though Airlift temporarily ceased operations prior to collecting sufficient data ... their best estimate is that the final results ... could reflect fuel savings in excess of 10% ..." Holmes does not tell his shareholders that Airlift went bankrupt in June, 1981 (Sovacool, p. 8), that after bankruptcy was filed, the aircraft (with the CD-3000 on it) was repossessed and when Airlift got it back, the CD-3000 was gone (Sovacool, p. 39). Holmes says that the tests are "expected to generate immediate sales" to operators of DC-8-63's (Airlift's type of craft).[105]

Further, the Airlift report itself, approved by Savacool but written by Aero Systems (Sovacool, p. 115; Exh. 1039),[106] Holmes admits writing most of the report (Holmes, p. 1906).

The report clearly states that 2% of the alleged fuel savings is speculative because tests "were interrupted"

[105]Note that several DC-8-63 operators were unable to use the CD-3000 to achieve maximum specific range, because instability resulted, forcing the pilot to burn additional fuel to regain stable cruise conditions. (*See, e.g.,* Exh. 3884). Further, by December, 1987, only one CD-3000 was sold to be installed in a DC-8-63 (Exh. 5284).

[106]Holmes admits that the Airlift report itself was *not* sent to shareholders (Holmes, p. 1966).



before comparative calculations could be made (Exh. 1039, p. 001 01592) and that the total resulting savings would be "*between* 4% and 6%" (*Id.*) (emphasis added), not that they would be "in excess of 6%" as he later tells his shareholders.[107]

Against this storm of hyperbole and unsupported representations by Holmes of the "fuel percentage savings" to his shareholders and the stock buying public, one must measure what Aero Systems *really* believed the CD-3000 could do.

On July 1, 1981 George Nelson, the recently hired Vice-President, Fuel Computer Marketing, who had the primary responsibility for the world-wide marketing of the CD-3000 (Exh. 5242), sent letters to Japan Air Lines, Gulf Air, Dan Air Service, Cathay Pacific Airways, All Nippon Airways, Air France, Muse Air, Deutsche Lufthansa, Sudan Airways, Transavia Holland and UTA guaranteeing *only* 2% fuel savings by use of the device (Exhs. 3848). Thus, what Holmes was telling the stock-buying public and what Aero Systems was telling those who were sophisticated in the business were two entirely different things.

* * *

## C. HOLMES PARTICIPATED IN AND ASSISTED IN THE BUNNINGTON STOCK MANIPULATION

Holmes was a direct participant of the Bunnington stock manipulation, and aided and abetted that manipula-

[107]Holmes' obsession with "percentage of fuel savings" is not to be underestimated. According to this own representations of the size of the market — 30 billion dollars — a one percent reduction in fuel costs, equals 300 million dollars! Thus, a misrepresentation of only 1% to his shareholders and the public is not a *de minimus* representation.

tion.[108] It was done by Holmes through Lugo and Moore Schley, both of which had so greatly benefited Holmes and Aero Systems.

1. Holmes Invested Heavily in Bunnington Through Private Transactions

Aside from the transactions between Holmes and Bunnington set forth above, and his relationships with the Bunnington principals, Holmes was familiar with Bunnington and was a substantial shareholder of Bunnington.[109] Holmes received Bunnington Annual Reports and shareholder letters (Holmes, p. 996).

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2. Holmes Actively Traded Bunnington

In addition to Holmes' purchase of Bunnington stock and the debenture through private transactions, Holmes traded heavily in Bunnington stock to assist Lugo and Bunnington in the manipulation of Bunnington stock.

During the period of time from September 3, 1977 through May 20, 1981, Holmes purchased 61,900 shares of Bunnington on the open market. The aggregate cost of the

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[108]It is the opinion of John Torkelsen, one of plaintiffs' experts, that the stock of Bunnington was manipulated (Torkelsen Decl. ¶ 22).

[109]Holmes also was familiar with Aerosonic. In January, 1980 Ronald Rotstein of Capitalgains spoke with Holmes (Exh. 2631). Rotstein asked Holmes about Aerosonic (Rotstein pp. 46-47). Holmes told Rotstein that Holmes "[k]nows Aerosonics — recording altimeters used in conjunction with collision avoidance systems (CAS) *have the capability to drastically reduce air crashes*" (emphasis added), but told Rotstein "no direct quote here" (Rotstein, pp. 46-47). It is this "CAS" device — again a gimmick that could *not* "drastically reduce air crashes" as Holmes misrepresents — that Aerosonic was hyping to push its stock price up.



purchase was $364,875.00 at an average cost of $5.79 per share. A total of 60,900 of the shares purchased were subsequently sold for total proceeds of $357,203.57, at an average price of $5.87 per share (Foley Decl. ¶ 90).

Holmes purchased 45,900 of the Bunnington shares through FSSC in twelve transactions (Foley Decl. ¶ 87). Holmes received preferential treatment from FSSC in connection with his purchases, at prices lower than the lowest NASDAQ reported asking price. This preferential pricing amounted to a total of $13,237.50 to Holmes' benefit (Foley Decl. ¶ 94). With the exception of one transaction, these securities were sold through broker-dealers other than FSSC in sixty-six separate transactions (Foley Decl. ¶ 95). This created the appearance of market activity, which had the natural result of artificially maintaining or raising the market price of the stock (*See* Foley Decl. ¶, 102).

Holmes' purchases assisted Lugo in creating market demand for the securities and controlling the public float of Bunnington stock (Foley Decl. ¶ 99). Nine out of twelve of Holmes' purchases between May 31, 1979 and May 20, 1981 represented more than 51% of NASDAQ's average daily volume (Foley Decl. ¶ 98). Further, between March 1, 1981 and July 24, 1981, Holmes was the largest single buyer of Bunnington stock, for 10,000 shares (Foley Decl. ¶ 99). This occurred at a time when there was little or no market demand for the stock (Foley Decl. ¶ 102).[112] During the same period, the largest seller of Bunnington stock was Vigman, selling 17,000 shares under Rule 144. (Foley Decl. ¶ 100)

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[112]During the March 1 through July 24, 1981 period, a total of 145,000 shares of Bunnington were sold by FSSC customers. Only 45,000 shares were purchased (Foley Decl. ¶ 100).

Holmes' profit from these transactions amounted to only $368.48. It is a triable issue of fact whether or not purchases at FSSC and subsequent sales were made for the purpose of assisting Lugo with the domination and control of the float of Bunnington common stock. (Foley Decl. ¶ 98, 99, 124)

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## N. HOLMES PARKED BUNNINGTON STOCK WITH LUGO

On May 18, 1981, FSSC's inventory reached an all time high of $688,378. Included in FSSC's inventory were 19,208 shares of Bunnington common stock with a market value of $235,298. At this level of inventory, FSSC's Net Capital was deficient by $136,222 (Foley Decl. ¶ 46).

In May of 1981, all trades through May 21st were included in FSSC's net capital computation for its monthly Net Capital Report to the NASD (Foley Decl. ¶ 52).[118]

In order to create the appearance of compliance with the Uniform Capital Requirements under SEC Rule 15C-3-1, Lugo "parked" securities with customers to conceal the true state of its inventory positions from the NASD (Foley Decl. ¶ 47).

Holmes' account at FSSC was one of the customer accounts used for parking securities that were properly attributable to FSSC's inventory. On May 20, 1981, an

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[118]FSSC reported its Net Capital to the NASD on a monthly basis, using the last Friday settlement as the closing date for financial statement and net capital computation. Trades as of May 21st were settled on May 29th, allowing five business days and one extra day to allow for the Memorial Day holiday, pursuant to the NASD Uniform Practice Code Paragraph 3504, Section 4 (Foley Decl. ¶ 52).



order to purchase 5,000 shares of Bunnington stock was entered in Holmes' account. The transaction reflected a purchase price of $61,250.00, with payment to be made by delivery to Holmes' bank, First Southeast National Bank of Miami Springs, Florida (Foley Decl. ¶¶ 49, 55).

The transaction reduced the value of the Bunnington inventory by $61,250, thereby reducing the amount of capital required by the SEC. However, this was not a *bona fide* transaction (Foley Decl. ¶ 51).

On May 29, 1981, an order to sell 5,000 shares of Bunnington was entered in Holmes cash account at FSSC, for a sale price of $61,875 to be settled on June 5, 1981 (Foley Decl. ¶¶ 49, 53).

On June 1, 1981, four days before settlement of the May 29 sale of the 5,000 Bunnington shares, FSSC made a prepayment of $61,875 to Holmes. This occurred prior to Holmes' payment for the purchase of the securities on May 20, 1981 (Foley Decl. ¶¶ 53, 54).

To make the prepayment on June 1, 1981, FSSC had to borrow funds from SCCP. An employee of FSSC, Robert Reber, delivered the check which Holmes endorsed over to his bank. On the same day, Holmes' bank wired $61,250 to SCCP to be credited to the FSSC loan account for payment of the stock originally purchased on May 20, 1981. Ordinarily, payment would be made by a draft sent to FSSC's own bank to be credited to FSSC's bank account (Foley Decl. ¶¶ 53, 54).

Through these transactions, Holmes "paid" for the 5,000 Bunnington shares with the FSSC's funds. This is known as a "free ride", and is expressly forbidden by a SEC Rule. Further, FSSC's inventory of Bunnington stock was increased by 5,000 at a value of $61,875 (Foley Decl. ¶¶ 61, 62)

The shares sold on May 29, 1981 (settling on June 5, 1981) appear to be the same ones purchased on May 20, 1981, although Holmes claims that they are not (Holmes, p. 2842). Holmes claims that the shares sold on May 29, 1981 were purchased on May 5, 1981 through Lugo in Holmes' DVP account at FSSC, and claims that they were delivered to cover the May 29, 1981 sale (*Id.*).

However, it does not matter which certificates Holmes delivered to cover the May 1, 1981 sale, since even if the certificates for the May 5 purchase were delivered, it still does not change the effect that the May 20, 1981 purchase had to mask FSSC's net capital deficiency. The transaction was a park, particularly because the sale takes place soon after the May net capital reporting period, and because the proceeds from the May 29, 1981 sale (paid in advance) were used to pay for the May 21 purchase (Foley Decl. ¶ 58).

The following chronology of the sale and prepayment on June 1, 1981 shows the coordination between Lugo and Holmes to execute the "parking" transaction, while maintaining the appearance of legitimacy:

a. Holmes endorsed the check;

b. Reber hand delivered the check to Holmes' bank on June 1 for deposit;

c. The bank stamped the check and sent it through the clearing house on June 1;

d. The bank wired to SCCP the $61,250 needed to pay for the DVP purchase on June 1 to credit the FSSC loan account;

e. FSSC borrowed $125,000 on June 1 to cover the check to Holmes;



f. Holmes paid for the stock purchase after he received the prepayment, in effect, using FSSC's own funds to pay for the purchase;

g. Holmes sold 53,900 shares on 64 different trades between March 2, 1979 and June 16, 1981. The 5,000 bunnington share sale on May 29, 1981 was Holmes' only sale through FSSC during the March 2, 1979 to June 16, 1981 period (Foley Decl. ¶ 63).

## B. THE EFFECT OF THE MANIPULATIVE SCHEME ON THE CAPITAL OF FSSC AND SEBAG

### 1. FSSC — March 1981 to July 1981

At the end of March 1981, FSSC had a capital deficiency. Although there was total capital in the amount of $209,917 — an excess of $67,841 — there was a deficiency of $120,273 in the Customer Reserve Account. Since there was only $16,000 in the FSSC checking account, Lugo should have either sold inventory to raise cash to meet the requirement or obtained a major infusion of capital from FSSC's principals. Lugo did neither (Foley Decl. ¶¶ 32, 33).

Between March 27, 1981 and April 24, 1981, FSSC's inventory value more than doubled, from $182,000 to $415,000. During this time, FSSC's capital declined 40% for a net capital deficiency of $16,625, and FSSC's Customer Reserve Account deficiency grew to $199,793. (Foley Decl. ¶ 34).

During this time period, Vigman made available to Lugo proceeds generated from the sales of Nettie Vigman's inflated Aero Systems stock to finance FSSC's continued operation, and to increase FSSC's inventory of the target securities. The credit balance in Nettie Vigman's account effectively provided Lugo with an inter-

est free loan of more than $230,000 in April 1981 (Foley Decl. ¶¶ 27, 34).

By the end of April 1981 Lugo was aware of FSSC's capital deficiency problem. He then ceased withdrawing his monthly compensation from the firm. Lugo used his salary and trading profits to relieve FSSC's deteriorating financial condition. At the close of the April reporting period for net capital, Lugo had to pay Nettie Vigman her credit balance. In order to do this, Lugo borrowed $100,000 from SCCP, and to conceal FSSC's financial condition, the loan was not recorded in FSSC's Customer Loan Account (Foley Decl. ¶¶ 27, 39, 40, 41, 42).

By May 29, 1981, FSSC had a net capital deficiency of $102,165. FSSC's inventory, adjusted to correct for securities parked by Holmes and others totaling ($213,125) was $619,000. The deficiency in FSSC's Customer Reserve Account was now $420,917. Again, to pay Nettie Vigman, Lugo borrowed $300,000 from SCCP, which was not reported in FSSC's Customer Loan Account (Foley Decl. ¶¶ 35, 39).

As a result of the "parks" in the accounts of Holmes and others, Lugo was able to create the appearance of capital compliance and FSSC's financial deterioration was shielded from the NASD. (Foley Decl. ¶ 36-38, 43)

Had FSSC ceased doing business in May 1981, FSSC's calculated losses would have been $779,594. However, by FSSC continuing in business through July 24, 1981, FSSC's losses increased to $2,634,976 (Foley Decl. ¶¶ 83, 84).

Without Holmes' participation in the May 1981 parking transaction, FSSC could not have created the appearance of net capital compliance. The concealment of FSSC's true financial condition allowed Lugo to continue in



business, and as a result, the financial condition of FSSC worsened. FSSC's continued operation after May 29, 1981, permitted the following to take place:

a. FSSC continued to build up its inventory in Bunnington and Aerosonic stock;

b. FSSC's Customer Loan Account increased by $1,000,000 at SCCP;

c. FSSC's net capital deficiency and related losses increased by more than $1.8 million; and

d. FSSC's trading losses and reserve deficiency increased from $779,594 (as of May 29, 1981) to $2,634,976 (as of July 24, 1981) (Foley Decl. ¶¶ 81, 86).

2. SEBAG, — May 29 to July 27, 1981

On May 29, 1981, Sebag had total capital of $1,900,000. There was only $110,000 of Aerosonic, Bunnington, Dash and Osrow stock in inventory. (Foley Decl. ¶ 64). However, during June and July 1981, Garrity purchased more than $7,000,000 worth of these stocks from FSSC and other market makers to stabilize the market price of the securities. Of this amount, 95% of the securities purchased were in Bunnington, Aerosonic and Osrow. These securities were sold to the accounts of Garrity, his family members, Velma Shaw, and other customers. However, 46% of these purchases were ultimately never paid for and were purchased into Sebag's inventory pursuant to Regulation T at a cost of $3,300,000 (Foley Decl. ¶¶ 65, 66, 67).

Of the purchases paid for, a substantial number were financed through margin accounts. These margin purchases increased Sebag's bank loans, for which Aerosonic, Bunnington and Aero Systems stock were pledged

as collateral. Losses resulting from a decline in the value of pledged securities exceeded $5,000,000 when the price of Aerosonic dropped from $11.00 to $5.00 and Bunnington dropped from $12.00 to $2.50 by July 27, 1981 (Foley Decl. ¶ 70, 74).

Had FSSC ceased operations at the end of May 1981 instead of July 24, 1981, the damages to both FSSC and Sebag would have been substantially less (Foley decl. ¶ 83)

3. SIPC's liquidation of FSSC and Sebag

Pursuant to SIPA, liquidation proceedings were initiated against FSSC and Sebag on July 24 and July 27, 1981, respectively. Under the provisions of SIPA, SIPC paid a total of $12,453,475.26 to the Trustee of FSSC and Sebag.

The acts of Holmes as set forth above led to and were a substantial contributing factor to the losses and damages incurred by SIPC and the two trustees.

## III.

## CONCLUSION

Holmes' activities as described in this memorandum are intentional and criminal, and were committed by Holmes not only for his own enrichment but to aid and abet the enrichment of Vigman, Diamond, Lugo, Garrity, Blumenthal and others.

Each historical relationship, each act and each profiting illustrates that Holmes' conduct must, at the very least, be weighed by a jury. Holmes did not act alone, and he didn't profit alone, as counsel for Holmes would have this Court believe. Holmes and the others, acting in concert since as early as 1966 must now sit in concert before a



jury so that their acts can be judged. Holmes motion must be denied.

Dated: September 20, 1988

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